

TOBACCO SETTLEMENT SECURITIZATION

1. TOBACCO SETTLEMENT SECURITIZATION-- OVERVIEW OF TRANSACTION [LFB Paper 885]

This item provides a brief overview of the proposed tobacco settlement transaction as modified by actions of the Legislature. A summary of the provisions of the bill relating to this proposal is provided in the following item.

Details of the proposed transaction relating to the sale of the state's rights to tobacco settlement agreement revenues are not included in the bill. The bill would establish statutory authority for the transaction, but the structure of the financing would be determined by the Secretary of Administration.

There are many ways the proposed transaction could be structured. Preliminary information from executive budget documents and DOA staff indicate that the transaction could involve the following elements. Under this scenario, an estimated \$1.26 billion in bonds or other obligations would be issued by the Wisconsin Health and Educational Facilities Authority or by a nonstock, nonprofit corporation formed for that purpose. Bond proceeds would be deposited in a statutory segregated permanent endowment fund.

From the permanent endowment fund, \$450 million would be transferred to the general fund to provide increased revenue in the 2001-03 biennium compared to current law. Under this scenario, bond proceeds would also be used to: (a) fund a debt service reserve of approximately \$137 million; (b) pay capitalized interest of \$188 million; (c) pay \$13 million of issuance costs; and (d) deposit \$470 million in the permanent endowment fund for long-term investment. The permanent endowment fund would be invested by the Investment Board.

The general fund would also receive \$155.5 million in 2001-02 and \$157.6 million in 2002-03 from tobacco settlement monies, which equal the estimated amounts to be received under current law. These monies could either be directly deposited into the general fund or flow through the permanent endowment fund, depending on the timing of the proposed sale.

Once bonds would be issued, debt payments to bondholders would be the first draw on the stream of tobacco settlement payments, while the state would retain a right to any revenues in excess of debt service required for the bond issue. Each year, once debt service payments on the bonds are paid, the remaining tobacco settlement revenue for that year would be transferred to the general fund. After the bonds would be paid off, all tobacco settlement revenue would flow through to the general fund.

Beginning in 2003-04, annual transfers would be made from the permanent endowment fund to the general fund and tobacco control fund. In general, these transfers would equal 8.5% of the balance in the fund.

2. TOBACCO SETTLEMENT SECURITIZATION -- ENABLING PROVISIONS [LFB Papers 885, 886 and 887]

	Governor (Chg. to Base)	Jt. Finance/Leg. (Chg. to Gov)	Net Change
GPR-REV	\$350,000,000	\$104,274,000	\$454,274,000
SEG-REV	658,854,800	104,274,000	763,128,800
SEG	\$658,854,800	\$104,274,000	\$763,128,800

Governor: Create the following provisions related to the sale of the state's rights to the Attorneys General Master Tobacco Settlement Agreement.

Sale, Assignment and Transfer of Tobacco Settlement Revenues. Establish a separate, non-lapsable trust fund designated as the permanent endowment fund, consisting of all of the proceeds from the sale of the state's right to receive payments under the Attorneys General Master Tobacco Settlement Agreement of November 23, 1998, and all investment earnings on the proceeds. Moneys in the permanent endowment fund would be used only to make the transfers to the general fund.

Create the following appropriations from the permanent endowment fund:

a. an annual appropriation for the transfer of \$350,000,000 SEG in 2001-02 to the general fund (\$350,000,000 GPR-REV). Specify that this appropriation would be repealed on July 1, 2003;

b. an annual appropriation for the transfer to the general fund of \$153,414,000 SEG in 2001-02, less any amounts received by the state under the tobacco settlement agreement in 2001-02. Specify that this transfer could occur no later than June 30, 2002, and the appropriation would be repealed on July 1, 2003. This transfer would ensure that the general fund would continue to receive the estimated amount of revenue in 2001-02 from the tobacco settlement (\$153,414,000) that is projected under current law, regardless of the timing of the proposed sale of the state's rights to these monies;

c. an annual appropriation for the transfer to the general fund of \$155,440,800 SEG in 2002-03, less any amounts received by the state under the tobacco settlement agreement in 2002-03. Specify that this transfer could occur no later than June 30, 2003, and appropriation would be repealed on July 1, 2003. This transfer would ensure that the general fund would continue to receive the estimated amount of revenue in 2002-03 from the tobacco settlement (\$155,440,800) that is projected under current law, regardless of the timing of the proposed sale of the state's rights to these monies; and

d. a sum sufficient appropriation from the segregated permanent endowment fund for the amounts to be transferred annually to general fund beginning on June 15, 2004. No funding would be transferred in the 2001-03 biennium and this would be the only appropriation from which endowment fund revenues could be transferred to the general fund after the 2001-03 biennium.

In relation to the sale of the state's right to tobacco settlement agreement payments, provide the DOA Secretary the authority to do the following: (a) sell for cash or other consideration the state's right to receive any of the payments under the tobacco settlement agreement; (b) organize one or more nonstock corporations or limited liability companies in accordance with state statutes for any purpose related to the sale of the state's right to receive any of the payments under the tobacco settlement agreement; and (c) take any action necessary to facilitate and complete the sale.

The bill would provide \$500,000 GPR in 2001-02 from a sum sufficient appropriation created under the bill to pay the costs incurred by the DOA Secretary in any sale of the state's rights to receive any payments under the tobacco settlement agreement and in organizing and initially capitalizing any corporation or company relating to sale of the state's rights to tobacco settlement payments. The fiscal effect of this funding is indicated under the "Administration".

The DOA Secretary would be allowed to enter into a contract with any firm or individual engaged in providing financial services for the performance of any of his or her functions relating to the sale, assignment or transfer of the state's tobacco settlement rights using selection and procurement procedures established by the Secretary. The awarding of any such contract would not be subject to the state's competitive, public notice and minority-owned business bidding requirements for state contracts. Further, such contracts would not be subject to the requirements for state contracts for contractual services, including the requirement that DOA prepare a written justification that the contract for services are necessary and the Department of Employee Relations review the contracts to ensure that the services of state employees are being utilized and to review the possible use of the limited-term employees of the state in lieu of the contract.

Specify the following related to the sale of the state's right to tobacco settlement revenues: (a) tobacco settlement revenues would mean the right to receive payments arising from, or pursuant to, the tobacco settlement agreement and all direct or indirect proceeds of that right; (b) the tobacco settlement agreement would mean the Attorneys General Master Tobacco Settlement Agreement of November 23, 1998; and (c) purchaser would mean any person who has purchased the state's right to receive any of the payments under the tobacco settlement agreement.

Specify that a sale, assignment, or transfer of tobacco settlement revenues would be an absolute transfer of, and not a pledge of or secured transaction relating to, the seller's right, title, and interest in, to, and under the tobacco settlement revenues, if the documents governing the transaction expressly state that the transaction is a sale or other absolute transfer. After such a transaction, the tobacco settlement revenues would not be subject to any claims of the seller or

the seller's creditors, other than creditors holding a prior security interest in the tobacco settlement revenues that is perfected in relation to the sale of tobacco settlement revenues.

The characterization of the sale, assignment, or transfer as an absolute transfer and the corresponding characterization of the purchaser's property interest would not be affected by any of the following factors:

- a. commingling of amounts arising with respect to the tobacco settlement revenues with other amounts;
- b. the retention by the seller of a partial or residual interest, including an equity interest, in the tobacco settlement revenues, whether direct or indirect, or whether subordinate or otherwise;
- c. the sale, assignment, or transfer of only a portion of the tobacco settlement revenues or an undivided interest in the tobacco settlement revenues;
- d. any recourse that the purchaser or its assignees may have against the seller;
- e. whether the seller is responsible for collecting payments due under the tobacco settlement revenues or for otherwise enforcing any of the tobacco settlement revenues or retains legal title to the tobacco settlement revenues for the purpose of these collection activities; and
- f. the treatment of the sale, assignment, or transfer for tax purposes.

Consideration could be given to these factors in determining whether the sale, assignment, or transfer is a sale for tax purposes. However, the characterization of such a transaction as an absolute transfer under the bill could not be considered in determining whether the sale, assignment, or transfer is a sale for tax purposes. The sale, assignment, or transfer would be perfected automatically as against third parties, including any third parties with liens created by operation of law or otherwise, upon attachment under the state's uniform commercial code for secured transactions.

Priority of Security Interests. Specify that a security interest relating to tobacco settlement revenues would be enforceable against the debtor, any assignee or grantee, and all third parties, including creditors under any lien obtained by judicial proceedings. The enforceability of the security interest would be subject only to the rights of any third parties holding a previously perfected security interest in the tobacco settlement revenues. Unless the applicable security agreement provides otherwise, a perfected security interest in the tobacco settlement revenues would be a continuously perfected security interest in such revenues that exist on the date of the agreement or that arise after that date. The security interest would priority over any other lien created by operation of law or otherwise, which subsequently attaches to the tobacco settlement revenues. Specify that that the priority of a security interest would not be affected by the commingling of proceeds arising from the tobacco settlement revenues with other amounts.

Specify that creation, perfection, and enforcement of security interests in tobacco settlement revenues would be governed state by the state uniform commercial code for secured transactions unless otherwise specified. Tobacco settlement revenues would be considered general intangibles for purposes of the state's uniform commercial code for secured transactions. Further, specify that the tobacco settlement revenues would not be deemed proceeds of any property that is not tobacco settlement revenues.

State Pledges Relating to the Sale. If the DOA Secretary sells the state's right to receive any of the payments under the tobacco settlement agreement, the state would pledge and agree to the following with any purchaser or subsequent transferee of the state's right to receive any of the payments under the tobacco settlement agreement:

a. the state would not limit or alter its powers to fulfill the terms of the tobacco settlement agreement, nor would the state in any way impair the rights and remedies provided under the tobacco settlement agreement;

b. the state would pay all costs and expenses in connection with any action or proceeding brought by or on behalf of the purchaser or any subsequent transferee related to the state's not fulfilling the terms of the tobacco settlement agreement; and

c. the state would not limit or alter the powers of the DOA Secretary relating to the sale, assignment or transfer of the state's right to the tobacco settlement revenues until any contract that is entered into is fully performed, unless adequate provision is made by law for the protection of the rights and remedies of the purchaser or any subsequent transferee under the contract.

The DOA Secretary would be allowed to include these pledges and agreements of the state in any contract that would be entered into by the DOA Secretary.

Claims Against the State. If the state fails to comply with the statutes or the terms of any agreement relating to the sale of the state's right to receive any of the payments under the tobacco settlement agreement, an action to compel compliance could be commenced against the state. If the recovery of a money judgment against the state would be necessary to give the plaintiff complete relief in such an action, a claim for the money damages could be joined with the claim commenced against the state. State statutes and rules governing claims made through the state Claims Board, or through the filing of a surety bond through a clerk of court and the preauditing of claims against the state by the DOA Secretary would not apply to claims against the state that relate to the sale of the state's right to the tobacco settlement revenues. If there is a final judgment against the state in a such claims action, the clerk of court would be required to furnish a duly certified copy of the transcript of the judgment to DOA. DOA would be required to audit the amount of damages and the costs awarded and pay those same amounts from the state treasury. In addition, the state would be required to pay interest, at the rate of 10% per year from the date such payment was judged to have been due until the date of payment of the judgment. These provisions would govern all civil claims, suits, proceedings, and actions

brought against the state relating to the sale of the state's right to receive any of the payments under the tobacco settlement agreement.

The bill would affirm the state's participation in the tobacco settlement agreement and would specify that all payments received and to be received by the state under the tobacco settlement agreement would be property of the state, to be used as provided by law, including a sale, assignment, or transfer of the right to receive such payments. No political subdivision of the state, and no officer or agent of any political subdivision of the state, would be allowed to have or seek to maintain any claim related to the tobacco settlement agreement or any claim against any party that was released from liability by the state under the tobacco settlement agreement.

State of Wisconsin Investment Board Investment Authority. Under a general provision of current law, specify that the State of Wisconsin Investment Board (SWIB), subject to certain prohibited investments under current law, would have exclusive control of the investment and collection of the principal and interest of all moneys loaned or invested from the permanent endowment fund, which would consist of all proceeds from sale of the state's right to tobacco settlement revenues. Specify that the endowment fund assets would not be part of the state investment fund. SWIB would be provided the authority to invest any of the assets of the permanent endowment fund in any investment that is an authorized investment for assets in the fixed retirement investment trust or assets in the variable retirement investment trust.

Specify that SWIB, if directed by the DOA Secretary, a statutory member of SWIB, would have authority to invest any of the assets in the permanent endowment fund in any of the following: (a) evidences of indebtedness, including subordinated obligations, that are secured by tobacco settlement revenues, and that are issued by any nonstock corporations or limited liability companies or by the Wisconsin Health and Educational Facilities Authority (WHEFA); and (b) certificates or other evidences of ownership interest in all or any portion of tobacco settlement revenues. The Board would be required to invest these assets subject to any terms and conditions specified by the DOA Secretary. In investing these assets, SWIB would not be subject the general standards of fiduciary responsibility that apply to the Board when it otherwise invests money or property.

Beginning in 2004, require SWIB, after June 1 but not later than June 15, to annually calculate the amount of moneys that are available in the permanent endowment fund for transfer to the general fund. For the purpose of this calculation, moneys that are available in the permanent endowment fund for transfer to the general fund would equal the sum of the following:

- a. an amount that equals 8.5% of the market value of the investments in the permanent endowment fund on June 1. The bill would specify that this calculation would not include any amounts or investments under (b) or (c);

b. all proceeds of, and investment earnings on, investments of the permanent endowment fund made at the direction the DOA Secretary that are received in the fiscal year; and

c. all other amounts identified by the DOA Secretary as payments of residual interests to the state from the sale of the state's right to receive payments under the tobacco settlement agreement that are received in the fiscal year.

Require SWIB to annually, beginning in 2004, submit a report that specifies the amount of funds that are available in the permanent endowment fund for transfer to the general fund to the DOA Secretary and to the Legislature.

WHEFA Authority. Authorize WHEFA to purchase the state's right to receive any of the payments under the tobacco settlement agreement, or make a loan to be secured by the state's right to receive any of the payments under the tobacco settlement agreement, upon such terms and at such prices as the authority considers reasonable and as can be agreed upon between the authority and the other party to the transaction. WHEFA would be allowed to issue certificates or other evidences of ownership interest in tobacco settlement revenues upon such terms and conditions as specified by the Authority in the authorizing resolution under which the certificates or other evidences are issued or in a related trust agreement or trust indenture.

Authorize WHEFA, or its executive director, to organize one or more nonstock corporations or limited liability companies, in accordance with state statutes, for any purpose related to purchasing or selling the state's right to receive any of the payments under the tobacco settlement agreement. The Authority, or its executive director, would be allowed to take any action necessary to facilitate and complete the purchase or sale.

Specify that WHEFA would have authority to issue bonds, and could only refuse to issue bonds if it determines the issuance would not be financially feasible, to finance a purchase, or make a loan relating to the purchase of the state's right to tobacco settlement payments. Any bonds issued would be payable from, or secured by interests in, tobacco settlement revenues and such other property pledged under the bond resolution. The bonds would be exempt from the current law requirement that bonds issued by WHEFA must mature in 30 years or less from the date of issue. The bill would include the tobacco settlement agreement revenues identified in the bond resolution for such bonds in the definition of revenues under the statutes that govern the Authority

Specify that any refunding bonds issued for purposes related to the purchase of the state's rights to payments from the tobacco settlement agreement would not be subject to the current law requirement that WHEFA enter into an agreement with a participating health institution, participating educational institution, or participating child care provider to provide sufficient revenues to pay the costs of bond issuance, including principal and interest, and to establish required reserves. Provide that refunding bonds issued would be treated the same as other bonds issued by WHEFA, except the current law limitation that bonds must mature within 30 years or less would not apply.

Financing Statements. Specify that if the state or the WHEFA is the debtor in any transaction for the sale and purchase of the state's right to tobacco settlement revenues, the Department of Financial Institutions would be the proper place to file the required financing statement to perfect the security interest. The required financing statement would be required to include a description of collateral that describes the collateral as general intangibles consisting of the right to receive settlement payments arising from or pursuant to the tobacco settlement agreement and all proceeds of that right. The required financing statement could include any additional description of collateral that is legally sufficient under the laws of the state.

Joint Finance: Modify the Governor's recommendations to securitize the state's annual tobacco settlement payments and deposit the proceeds from the transaction into a newly-created segregated permanent endowment fund and transfer \$450 million SEG from the endowment fund to the general fund, rather than \$350 million under the bill. Modify various provisions related to the securitization transaction as follows:

a. Require that after any bonds secured by the state's tobacco payments are issued, the DOA Secretary must submit a report to the Committee on the transaction and on the distribution of the bond proceeds;

b. Delete the authority provided to the DOA Secretary to annually direct SWIB to transfer amounts from the permanent endowment fund and, instead, beginning in 2003-04, require the Joint Committee on Finance to transfer these amounts at its fourth quarter meeting under s. 13.10 of the statutes.

c. Delete the authority of the DOA Secretary to direct SWIB on the types of assets in which the Board could invest the permanent endowment fund and the exemption of SWIB's fiduciary responsibilities in the investments of those assets. Specify that SWIB could hold: (a) evidences of indebtedness, including subordinated obligations, that are secured by tobacco settlement revenues, and that are issued by nonstock corporations or limited liability companies or by the Wisconsin Health and Educational Facilities Authority (WHEFA); and (b) certificates or other evidences of ownership interest in all or any portion of tobacco settlement revenues.

d. Reestimate the tobacco settlement payment revenues to be received under the tobacco settlement agreement and deposited into the general fund or flowing through the permanent endowment fund, depending on the timing of the sale of bonds, by an additional \$2,112,000 in 2001-02 and \$2,162,000 in 2002-03.

e. Delete the Governor's recommendation to provide \$500,000 GPR in 2001-02 for contracting for financial services related to tobacco securitization, but retain the appropriation for this purpose modified to be an annual, sum certain appropriation; and

f. Delete the provisions that would exempt the contracting of financial services related to the tobacco securitization transaction from the state's competitive, public notice and minority-owned business bidding requirements for state contracts.

Senate: Create a Thomas T. Melvin Tobacco Control endowment fund to which \$313 million in proceeds from revenue bonds secured by the state's tobacco settlement payment revenues would be deposited. Specify that the \$15,345,100 GPR transfer to the tobacco control fund under the Joint Finance version for appropriation from the tobacco control fund would be deleted after 2002-03. Specify the following related to the newly-created endowment fund:

a. Provide the Investment Board authority to invest the assets of the fund, and specify that the assets of the endowment fund could not be invested in a parent company of a tobacco manufacturer or a subsidiary of a tobacco manufacturer.

b. Beginning in 2003-04, require that the first \$31 million in earnings on the endowment fund would be transferred to the segregated tobacco control fund each year to fund the Tobacco Control Board activities and that, of this amount, all but \$30.5 million annually would be deposited to an all moneys received appropriation for grants to be distributed by the Tobacco Control Board in 2003-04 and each subsequent year.

c. Specify that if the annual earnings to the endowment fund would not generate \$31 million in a given year, the difference could be taken from the principal balance of the endowment fund, which would not be allowed to have a balance of less than \$313 million.

d. Specify that any earnings in excess of \$31 million in a year would be added to the principal balance of the endowment fund until the principal balance in the fund exceeds \$500 million; and

e. Specify that when the principal in the endowment fund exceeds \$500 million, any earnings in excess of \$31 million in a year would be deposited to the general fund.

Conference Committee/Legislature: Modify the Joint Finance provision to provide that, annually, beginning on June 15, 2004, the Joint Finance Committee would transfer from the permanent endowment fund to the tobacco control fund the lesser of \$25,000,000 or 8.5% of the market value of the investments in the permanent endowment fund on June 1 in that year.

Under the Joint Finance provision, beginning in 2002-03 and each year thereafter, \$15,345,100 would be transferred from the general fund to the tobacco control fund. This provision would increase the transfer to \$25,000,000 in 2003-04, and provide that the funds would be transferred from the permanent endowment fund instead of the general fund. [For more information on the tobacco control fund, see the "Tobacco Control Board."]

Veto by Governor [F-25]: The Governor's partial veto deletes a provision relating to transfer of these funds that cross references a statutory section that existed in the bill as originally introduced, but was deleted by subsequent actions of the Legislature.

[Act 16 Sections: 100m, 266, 801, 938 thru 944, 1102, 1109, 1111, 1112, 1113, 1136g, 1137, 1140, 1141, 3087 thru 3095, 3492, 3863 and 9459(1)]

[Act 16 Vetoed Section: 940]

3. MINORITY INVESTMENT FIRMS AND FINANCIAL ADVISORS

Senate: Specify that the Secretary of Administration could not enter into a contract with a nonstock corporation relating to the sale of the state's rights to tobacco settlement monies under the proposed tobacco securitization transaction unless the corporation complies with the following requirements: (a) if bonds would be issued by the corporation secured by tobacco settlement revenues, at least six percent of the bonds are underwritten by minority investment firms; and (b) if such bonds would be issued, at least six percent of the total monies expended for the services of financial advisors are expended for the services of minority financial advisors.

Conference Committee/Legislature: Delete provision.